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## DIRECTORATE OF INTELLIGENCE

9 April 1986

**Nakasone's Meeting With the President: Accentuating the Positive** 

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**Summary**

Prime Minister Nakasone appears to view his visit to the United States next week, like his earlier trips to Europe and Canada, as paving the way for a successful economic Summit this May. As a result, he will probably sound out US officials on potentially contentious issues, such as a political communique proposed by Japan that urges closer ties between Atlantic and Pacific nations. In an attempt to accentuate the positive, Nakasone probably also will talk up the recently released Maekawa commission report on structural adjustment that recommends steadily reducing Japan's current account imbalance. In the process, the Prime Minister almost certainly will try to forestall new US demands on the trade front that could prove politically difficult for him because of the Upper House elections scheduled for this June.

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This memorandum was prepared by  Office of East Asian Analysis.  
Information available as of 9 April 1986 was used in its preparation. Comments and queries are welcome and may be directed to the Chief, Japan Branch, Northeast Asia, OEA .

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Since taking office over three years ago, Prime Minister Nakasone has made his role as spokesman for Japan on the international stage the centerpiece of his political strategy. He has maintained an active calendar of high-profile diplomatic consultations--in East Asia as well as in Europe and the United States--that have clearly paid political dividends at home. He sees this visit to Washington as very important to his political future. With his second two-year term as president of the ruling Liberal Democratic Party--and therefore prime minister--coming to an end in October, he faces a turning point in his career. [REDACTED]

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[REDACTED] Nakasone would clearly like to maneuver a change in party rules that would permit him to serve a third term. [REDACTED]

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[REDACTED] Even with a successful visit to the United States and a well orchestrated Summit this goal appears to be a long-shot. Without them, we believe it would be impossible. [REDACTED]

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### **The May Economic Summit: At the Top of Nakasone's Agenda**

At least in Japan, Nakasone's "success" in hosting a summit will be measured by how well he defends Japan's national economic policies. In Nakasone's view, the trip to the United States probably affords an opportunity to enlist US help on this score. As in the past, Nakasone will probably seek assurances that the United States will not echo EC criticism of Japanese trade practices. He may also appeal for a united front against any European suggestion that Japan use fiscal stimulus--increasing budget outlays--to improve global economic prospects. [REDACTED]

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We expect the Prime Minister will sound out the President on potentially contentious positions Japan may take at the Summit:

- The Prime Minister is almost certain to mention the political communique he would like Summit countries to endorse. Reporting from the US Embassy in Tokyo suggests the Japanese want to call for continued unity of Western countries regarding East-West relations as well as for cooperation between Atlantic and Pacific states, a pet theme of Nakasone. Officials in Tokyo are concerned the communique may be derailed by French opposition to discussing political issues at the Summit, and about the lukewarm reception Canada has given Nakasone's Atlantic-Pacific initiative.
- Nakasone may seek an elaboration of US policy concerning falling oil prices. Although Japan stands to benefit handsomely from lower energy costs, officials in Tokyo fear collapsing oil prices will accelerate the appreciation of the yen--causing additional problems for exporters--and will deprive the government of oil tax revenues, making it more difficult for the Finance Ministry to achieve its goal of balancing the budget by 1991. US officials have tried to dissuade Trade Minister Watanabe from putting the topic forward, but recent comments by Vice President Bush may have raised hopes in some quarters that US opposition to such a discussion is fading. [REDACTED]

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**Bilateral Issues: Trying to Succeed Without Paying the Price**

We believe that when Nakasone originally scheduled his visit to the United States, he had hoped to announce measures to mollify US critics of Japanese trade practices and to ensure positive media coverage. A public announcement of Japan's participation in SDI research was an obvious choice. Domestic opposition, particularly from Foreign Minister Abe, who is trying to improve his prime ministerial prospects by taking an independent line on foreign policy matters makes such a declaration highly unlikely. [REDACTED]

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[REDACTED] the Prime Minister also may offer private assurances that Japan will use its expanding aid budget to buttress US strategic interests. Nakasone has broad latitude to increase aid as long as he publicly claims the aid will be given for humanitarian reasons. If he bills it as strategic aid, however, he will probably face harsh criticism within Japan, particularly from opposition parties. Press reports indicate Nakasone plans to bring up aid to the Philippines during his visit. [REDACTED]

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Faced with the problem of trying to make the visit a positive media event, Nakasone will probably talk up the recently released report of the Maekawa commission on structural adjustment. In October 1985, the Prime Minister charged his special advisory group--headed by respected former Bank of Japan Governor Maekawa--with devising long-term measures to reorient growth away from exports. [REDACTED] Nakasone ordered a rewrite of the first draft because it was short on specifics--a problem he probably has with the version finally released on 7 April--but we expect the Prime Minister to tout the report as an important step in dealing with the trade imbalance (see table for details on report). Such a strategy might help Nakasone avoid new calls for Japan to undertake tough short-term sectoral measures to narrow its trade surplus, demands that would prove politically difficult for Nakasone to handle as Japan enters an election season. [REDACTED]

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**Nakasone's Domestic Position: At a Crossroads**

Nakasone has indicated he wants to hold elections for both houses of the Diet in June. This involves finding a pretext to dissolve the more important lower house and holding a general election to coincide with the scheduled upper house contest. Nakasone clearly believes "double elections" would yield a big LDP win, and provide him with a stronger case for a third term. The high voter turnout that would result from general elections should favor the LDP. The LDP may repeat a past mistake, however, by running too many candidates--as aspiring prime ministers try to enlarge their factions--and splitting the conservative vote. At present, the LDP candidate roster is 80

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above the 330 level that political analysts consider ideal, and unless this is pared down the LDP would find it difficult to recoup the 36 seats lost in the December 1983 lower house elections. [REDACTED]

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The preoccupation of Japanese politicians with election possibilities may temper Nakasone's near-term willingness to address new US policy initiatives as well as the Diet's willingness to act on them. The Prime Minister has already admitted that he foresees problems in getting the Diet to implement many of the Maekawa commission's recommendations. [REDACTED]

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Table 1. Japan: The Maekawa Commission Report and the Saving-Investment Imbalance

Reforms Needed to Ease the Imbalance	Recommended by Maekawa Commission	Specific Implementing Measures in Commission's Report	Comment
I. Short-term measures			
Increase public works spending	Yes	Promote infrastructure spending by local governments.	Commission recommends that Tokyo maintain its basic fiscal policy stance of eliminating deficits in its budget for operating expenditures by 1991. This strongly held position probably precludes major fiscal stimulus. Local government ability to issue bonds constrained by Finance Ministry regulations.
Across the board tax cut to spur consumption	Yes	None	Diet may pose small tax cut before this summer's elections. Larger cuts may be introduced in next year's tax reform package, and will probably be accompanied by new indirect taxes to make up for lost revenue.
II. Longer-Term Measures			
Tax reform to change incentives to save, consume, and invest	Yes	Review tax treatment of savings. Abolish tax-free small savers accounts; expand tax deductions in connection with housing purchases.	Both government and party tax councils are drawing up reform packages to be presented to the Diet this year. Some cuts in personal and corporate tax rates likely but not until 1988 at the earliest. Government has failed in several past attempts to end tax-free status for small savers accounts.
Encourage housing construction	Yes	Expand tax deductions for housing. Ease zoning and other restrictions that drive up building costs.	Powerful Finance Ministry likely to oppose making mortgage interest payments tax deductible. Changing zoning and other laws that protect agriculture will be politically difficult. Maekawa Commission recommends relying largely on private sector initiative.
Promote Five-Day-Work-Week	Yes	The Japanese government should take the first step by implementing a 5-day-week for its employees.	Any moves in this direction will be slow and require change in work habits. Some large corporations already have 5-day-weeks, but many employees work full Saturdays anyway.

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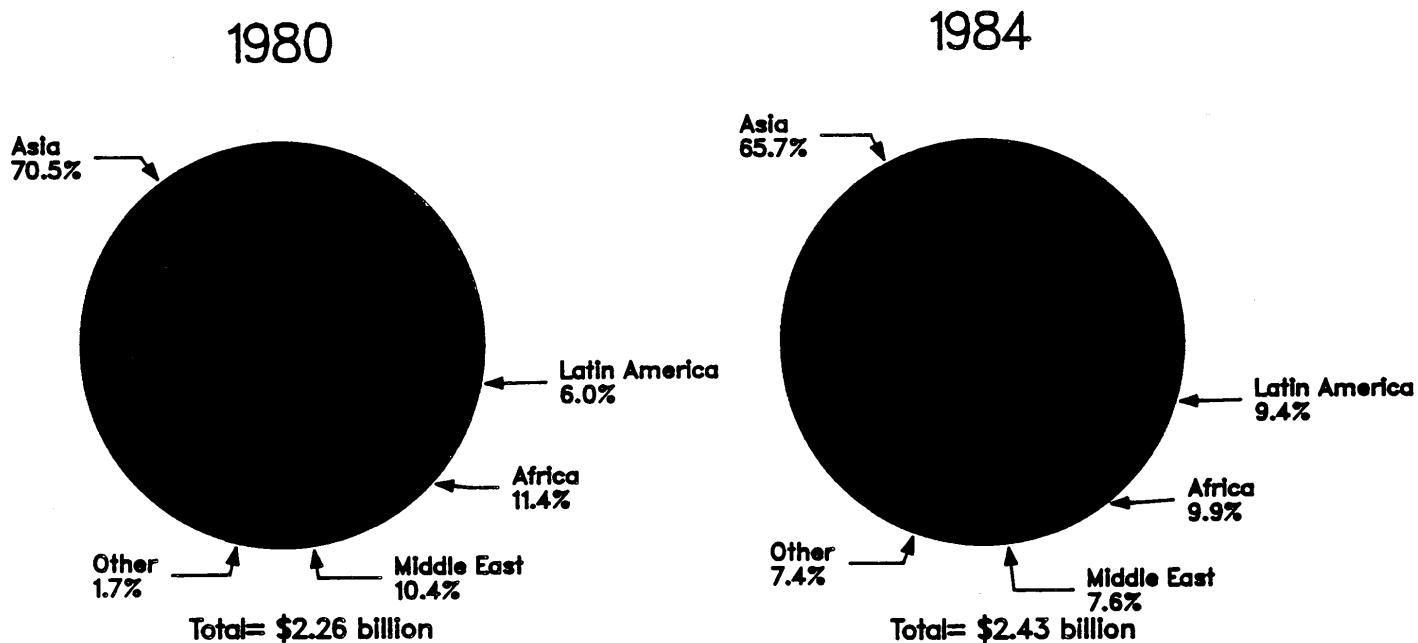
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Reforms Needed to Ease the Imbalance	Recommended by Maekawa Commission	Specific Implementing Measures in Commission's Report	Comment
Deregulation	Yes	Ease restrictions that stifle private investment and retard competition among firms.	Some progress made under the government's administrative reform campaign. Further progress will be slow.
Consumer credit measures	No		Despite strong emphasis on increasing consumption, the report made no specific reference to consumer credit.
Financial liberalization	Yes	Further liberalize capital and financial markets. Accelerate development of short-term financial markets. Examine impact of tax laws on financial markets.	Substantial progress made in past few years. There is a possibility that freeing interest rates will increase average return to small savers, possibly encouraging more saving.



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## Japanese Foreign Aid Disbursements, by Region



Overseas Development Assistance basis;  
does not include multilateral aid disbursements of  
\$1.34 billion in 1980 and \$1.89 billion in 1984.

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